RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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July 15, 1998 **LETTER 1256**

July 2 DJIA 9025.26; PTI 5342; A-D Ratio +10.22
July 10 DJIA 9105.74; PTI 5358; A-D Ratio +10.32
Dow Yield: 1.61%; Dow Price/Earnings: 23.1
Dow 144-day MA: 8669; Dow 34-day MA: 8978
Dow Times Book Value: 5.71; PTI 89-day MA: 5314
Percentage of Undervalued Blue-chips: 4%
Gold 34-day MA: 300

THE PICTURE: What fascinates me about this business is not only the idea of hopefully being right and making some money in the market; no, as much as profits, it's the meaning behind the movements of stocks, bonds, money. Do you want to know what's going on in politics, governments, corporations, industry trends, agriculture, education, you name it? If you really want to know -- then **follow the money.** That may sound cynical, but money is power and the markets tell us where the money and power is going.

OK, if that's true then let's follow the money. We already know that the S&P has advanced to new record highs. Therefore, the "problem average" at this time is the world's most watched average, the Dow. Technically, how's the Dow acting? I've included a chart of the Dow and its 34-day and 144-day moving averages on page 1. The Dow hit a record high of **9211.84** back on April 13. From there the Dow went into a correction that ended with a low closing of 8627.93 on June 15.

Now turn to the two moving averages. Note that the downside pressure on the Dow was not powerful enough or persistent enough to force the 34-day MA below the 144-day MA; for that matter, the 34-day MA never even got close to the 144-day MA. Then on June 24 the Dow rallied and closed **above** its 34-day MA. This was a bullish signal under my method of reading the moving averages. Since June 24 the Dow has held persistently above its 34-day MA. Holding above its 34-day MA is what I term being in the bullish mode.

The question now is, "Can the Dow generate enough strength to confirm the action of the S&P 500?" A confirmation, of course, would entail the Dow rallying to, and then above, its April 13 record high of **9211.84.** Since we take the primary trend of the market as remaining bullish, it should therefore only be a matter of time before the Dow does advance to new record highs.

Question: Russell, let me play devil's advocate. Look, it's been two months since the Dow registered its all-time high. It's been two months since the Transportation Average hit its record high. The advance-decline ratio recorded its high back on April 3. Secondary and less-than-blue chip stocks have been lagging badly. So how do we know that we're still in a primary bull market?

Answer: Under Dow Theory the trend is taken to **continue** until proved otherwise. So far, despite the messes in Japan, Asia, Russia, etc., despite indications of a slowdown in US business, despite a very negative US current account balance, we've received no Dow Theory bear signal. Furthermore, my Primary Trend Index has had every opportunity to break down -- and it hasn't done so.

True, the market has given us plenty of food for worry. True there have been numerous lags, divergences, and discrepancies in the price action. But my two most trusted barometers, the Dow Theory and my PTI have not signaled a bear market. In the absence of bearish signals, I take the primary trend to remain bullish.

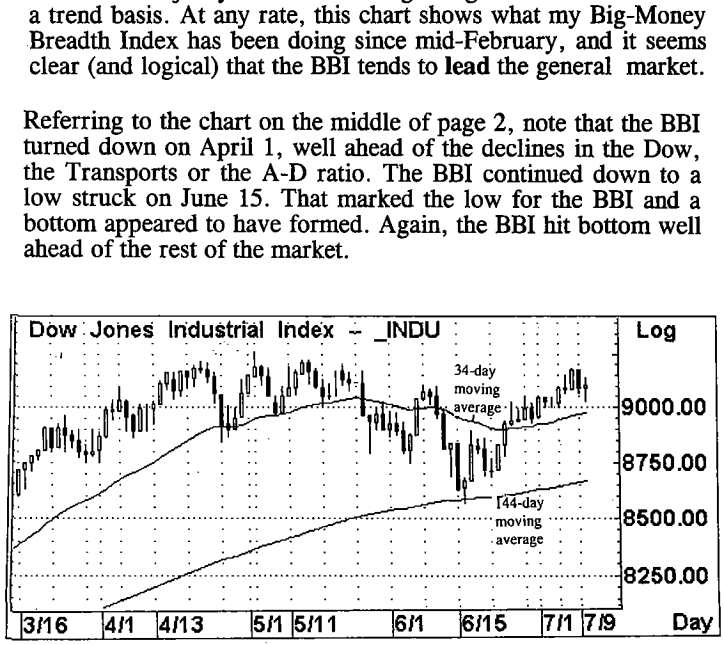
Question: Aren't you impressed by the facts that margin accounts are at record highs, that public shorting is very heavy, and that bearish sentiment is increasing as bullish sentiment sags? How much importance do you give to all these normally bullish indications?

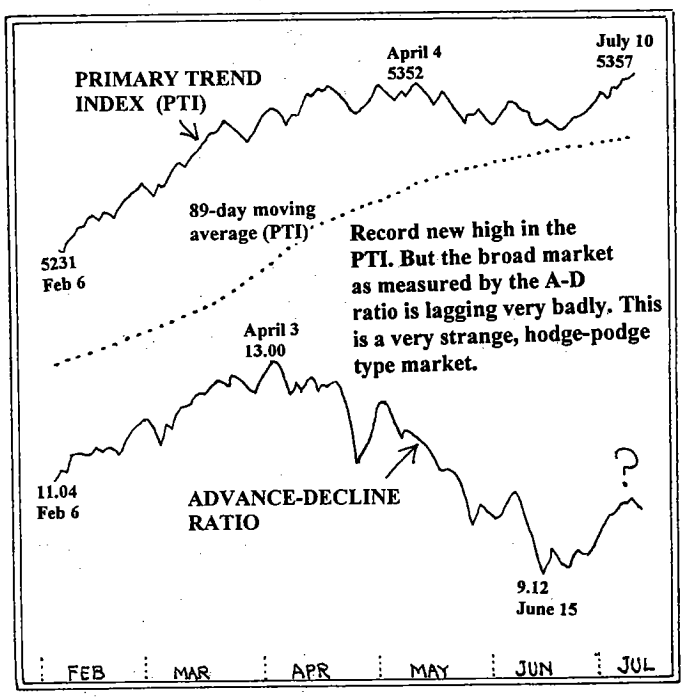
Answer: Obviously I monitor all these indicators, plus dozens more. But frankly, I put much more credence on my reading of **the Averages** plus my interpretation of the **PTI.** By the way, last week on July 8, the PTI rose to a new record high of **5356.** In interpreting the PTI, I note its actual level and whether it has broken above or below preceding highs or lows. Nevertheless, I give more credence to the **current trend** of the PTI. Is it advancing or declining and how persistent is the trend?

Back in 1971 I introduced my Primary Trend Index (PTI). That was one of the best things that I've ever done (at least from my standpoint it was), and I've often stated that the PTI is a lot smarter than I am. Now I'm going to introduce another indicator or barometer, which, I believe, should be of considerable help in our analysis of the market trend.

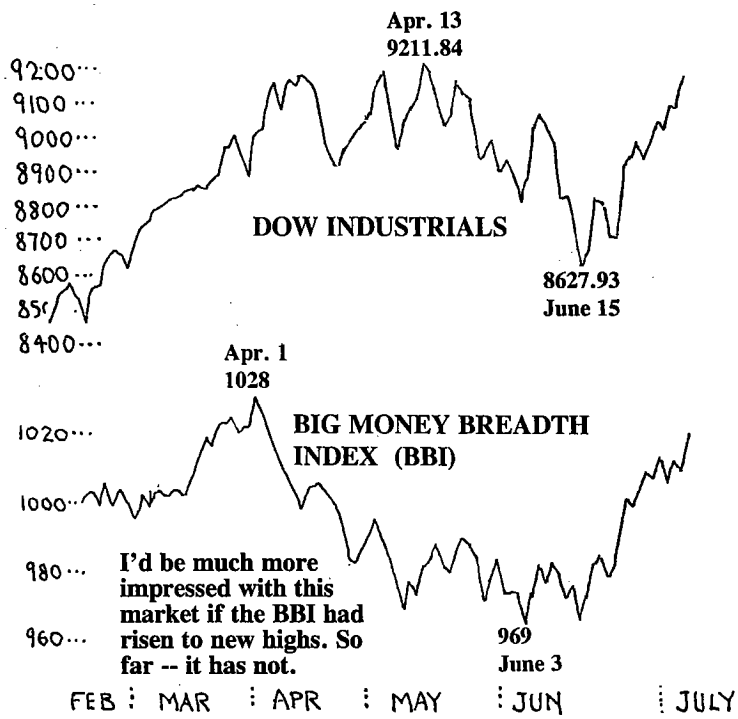
I call this new study my **BIG-MONEY BREADTH INDEX (BBI):** This is how it works. I run an advance-decline line based on the action of the **10 largest capitalization stocks** in the S&P 500. These 10 stocks have a market capitalization of about $1.5 trillion; they account in value for almost **20% of the value of the entire S&P 500.** On the thesis that "big money" (wealthy, sophisticated money) **leads** the market, and that big money tends to deal with the largest big-cap stocks, I have put together what I call my Big-Money Breadth Index. The concept is that if the **majority** of these 10 monster stocks trend higher, the economy and the stock market should be in good shape. The reverse is true if the majority of these 10 King Kong stocks head down on a trend basis. At any rate, this chart shows what my Big-Money Breadth Index has been doing since mid-February, and it seems clear (and logical) that the BBI tends to **lead** the general market.

Referring to the chart on the middle of page 2, note that the BBI turned down on April 1, well ahead of the declines in the Dow, the Transports or the A-D ratio. The BBI continued down to a low struck on June 15. That marked the low for the BBI and a bottom appeared to have formed. Again, the BBI hit bottom well ahead of the rest of the market.





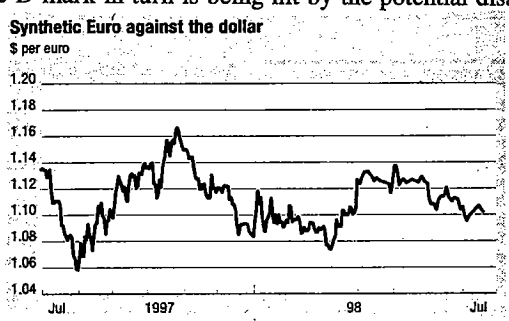
Then on June 23 the BBI broke out to the upside, moving to its best level since late-April. The BBI has a way to go before it can hit a new high -- and obviously there's no guarantee that the BBI will advance to a new high. At any rate, the BBI appears to be a valuable new **lead** indicator, and it's well to note that the BBI has been far stronger than the weak and lagging A-D ratio, meaning, of course, that the largest high-cap stocks are doing the upside work while the majority of stocks are lagging badly. That's not normally a healthy situation, but we take what the market gives us.

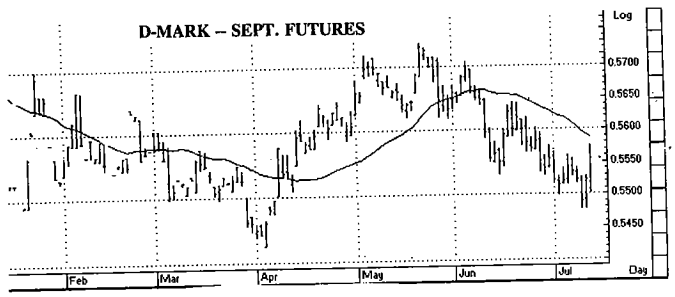


OVERALL CONCLUSION: It's still a bull market. There are lags, non-confirmation, confusing, ragged movements, plenty of items to worry about -- but as long as the PTI and the BBI continue to rise, the trend must be considered UP.

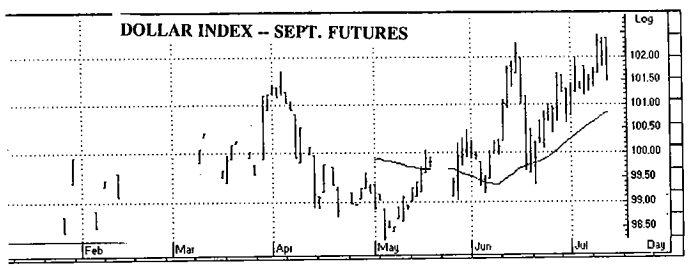
THESIS: If it's still a bull market, then **by definition** it's only a matter of time before the Dow and the Transports confirm on the upside. After that -- we'll see. **Question:** What happens if weeks or even months go by, and the Dow refuses to go to a new high? If that's the case, and the Dow then turns down (along with the Transports) and violates its mid-June lows, then we've got "something else." It would be a "something else" that we most definitely would not want.

CURRENCIES: Increasingly, it seems, currencies run the markets and I guess you could say that currencies now may even be running the world. Here are the most recent developments. Looming over the horizon is the euro, and euro options are already being traded. Here's a chart of the "synthetic" euro, synthetic because it's not the actual euro itself but a derivative. But we see a slight downward bias for the euro against the dollar. This is mainly because of the current weakness in the D-mark (the D-mark in turn is being hit by the potential disaster in Russia).

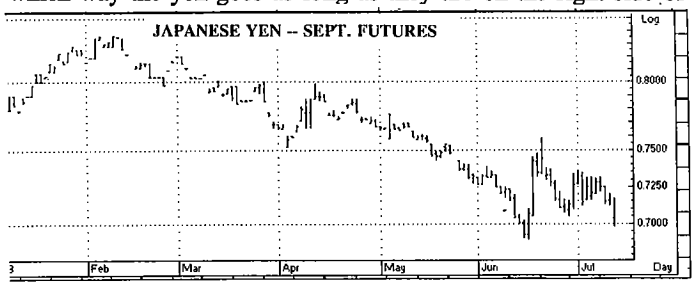




In the meantime, here we see the Dollar Index (Sept. futures) surging on July 9 to a new high. All the world, it seems, want to own the Yankee buck (my wife, just back from Paris, reports that even the French, who hate everybody, love dollars).



Finally, we see the rotten action of the Japanese yen. The 34-day moving average has acted as a "yen killer." Twice in June the yen pushed above its 34-day MA and each time the yen was turned back. Last week the yen fell out of a triangle -- just not good action. Secretary Rubin wants a strong yen, Japan wants at least a stable yen, US exporters want a much stronger yen -- and the FOREX (foreign exchange traders) crowd don't give a damn which way the yen goes as long as they are on the right side of



INVESTMENT POSITION: In life, nothing's easy. In investing, nothing's easy. If life and investing were easy, we'd all be happy and rich. Doesn't seem to work that way. So we struggle. In case you didn't notice, that long-horned bull is still in the box.

Breadth: The dreadful breadth performance continues to bother me. I don't think I've ever seen a case where the A-D, lagging this far behind, has ever turned around and then advanced to new highs. In the past a breadth performance as poor as this has invariably led to trouble. The problem, of course, is the timing. lagging breadth can have a lead time of a few months to a year.

Then there are the bonds, which I've been suggesting for many months. In the last Letter I said that the bonds had made a huge move, and that maybe it was time to cool it. The September bond futures halted at around 124, a level which stopped the bonds in mid-June. A lot of bond super-bulls are now talking 5% yields on the long bond. I don't know, mebbe. At this point, I'd hesitate to go out more than five years. I still like the bonds, but I just wouldn't load up on them the way I did many months ago. I'm not a piggie and I avoid stress -- which is maybe why I'm still around.

The difference in stock commissions between the "big houses" and the discount houses is now ridiculously large. Go to the Net and the spread is even more ridiculous. On the Net some outfits are charging $12.50 and even less for up to 5000 shares. In time, it seems to me that almost all stock transactions will take place via the Web.

NOTES & QUOTES: Wall Street loves fads. What are the current fads? There are two: **(1)** Matching a companies earnings announcement with the analysts' estimates. ("Oh, it's better than the estimates by three cents -- let's buy it.") **(2)** Buying any stock with a ".com" in its name. ("General Sandwich just changed its name to Gen-san.com, buy it, buy all you can get.")

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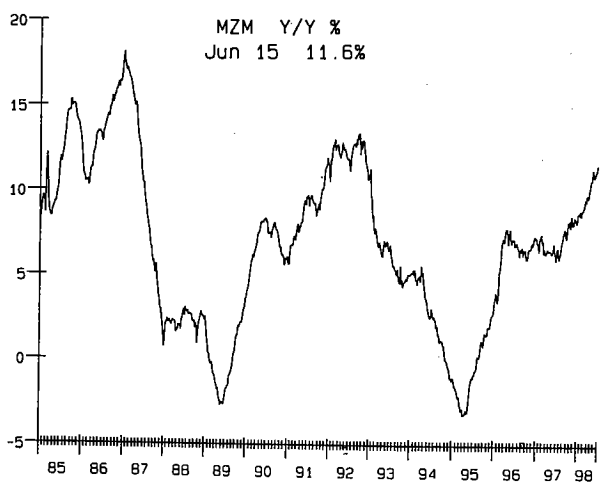
Despite Fed Chairman Greenspan's oft-reported worries about inflation, the US money supply continues to boom. Ed Hyman of *ISI* feels that MZM, money of zero maturity, dove-tails best with the direction of the stock market. Here's the Hyman/Lazar chart of MZM on a year-to-year percentage-change basis. To put it politely, MZM is booming. With business now slowing down, it would seem that all this excess liquidity is siphoning into today's highly-speculative financial markets. So an interesting battle is taking place -- increasing liquidity confronting a slowing economy. On the housing front, however, the word is white heat. In Seattle, builders are putting up million-dollar houses on spec, hoping, I guess, to sell them to the growing crowd of Microsoft millionaires.



More Millionaires

About 12.17 million Californians filed state income tax returns for 1996. While the numbers of the wealthiest grew significantly, 93% of state residents reported adjusted gross incomes of less than $100,000.

1996 INCOME BREAKDOWN

Income	% of total	% change '94-96
Negative to zero	1.0%	-27%
$1 to $10,000	20.8%	+2%
$10,000 to $20,000	20.3%	-0.4%
$20,000 to $50,000	33.8%	-0.02%
$50,000 to $100,000	17.6%	+2%
$100,000 to $200,000	5.0%	+32%
$200,000 to $500,000	1.2%	+32%
$500,000 to $1 million	0.2%	+44%
$1 million and over	0.1%	+66%

* *

California is booming. So let's see how the folks in my state are actually doing. Here's the rundown. Note that 41% of the state's residents make $20,000 or less. A rather shocking 76% of the state make $50,000 or less. Then we have 17.6% of the residents who make $50,000 to $100,000. Only 5% make $100,000 to $200,000. A tiny two-tenths of 1% make half a million to a million. Finally, one-tenth of 1% (one out of a thousand) makes over $1 million. And remember, these figures are before taxes. Frankly, I don't see how most people make ends meet. Oh yes, I forgot about borrowing.

* *

The flight from Asian currencies, particularly from the yen, into the dollar, has hidden a lot of US problems. The main ones are the negative trade balance, which is at a record, and then there's the hugely negative current account balance (this latter includes all cash flow, trade in goods and services, net investment income and foreign transfers). The current account balance for the first quarter hit a record negative $47.2 billion. At an annual rate, that was 2.3% of GDP and the deficit is on track to hit 2.5%. In the face of these figures, it's amazing that the dollar can hold up. It seems the market is more afraid of the Asian crisis than it is of US deficits.

* *

Europe's markets have been roaring, but the real fly in the ointment is Russia. Some experts believe that an imminent Russian collapse could be more important for the rest of Europe than the Asian collapse. The world is watching the ruble, and the tip off for major trouble in Europe would be a further ruble collapse.

* *

It's interesting how one person can affect another in what at the moment seems trivial or incidental. Last week in the *NY Times* there appeared a lengthy obituary of the poet, John Malcolm Brinnon. Brinnon died in Key West at the age of 81. Brinnon was an author, poet, and close friend and biographer of the great poet, Dylan Thomas. Back in 1947 I took a course under Brinnon, a course on the short story given at New York's 92nd Street "Y." That was my first serious attempt at writing (I wrote a short story about my first combat mission). One day Brinnon took me aside and said, "Richard, it's not easy for me to teach these classes, most of the students are eager but without much ability -- but I want to tell you that you have the talent to be a really good writer." What he said struck me like a thunderbolt. Here was an author very close to the great Dylan Thomas telling me that he liked my writing. It was just a passing compliment. But Brinnon's comment gave me the courage to think, "Hey, maybe he's right; maybe I can write." And here I am in 1998, still remembering what John Malcolm Brinnon told me 51 years ago. Of such seemingly minor occurrences are lives changed and careers made.

* *

Falling Yen: The fallout from the yen is not pleasant. First, the falling yen has forced Japanese banks to pull back from Asian lending even faster than they had originally rushed in. Asian companies had relied on Japanese lending for one-third of their loans. And it was these loans that had a large part in the region's rapid expansion. The statistics are interesting. For instance,

Thailand now owes Japanese banks $34 billion in private debt. S. Korea owes $20 billion. Indonesia owes $22 billion. China owes $20 billion. Malaysia owes $9 billion. And so on. The falling yen also presents painful problem for US marketers. What do you do if you're selling goods to Japan and the yen is falling. Do you take a chance and raise your prices? Or do you hold your prices and cut into your profits?

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Clinton in China: I was for it. It's obvious (at least to me) that China has become the leader in Asia and soon to be the world's second super-power. China comprises one-fifth of the global population. You want to exclude them? You want to turn them against us? China's leaders have decided to allow the country to adopt capitalism and private enterprise. China's leaders watched the disastrous Russian example and they realized that a closed economic system run by the state doesn't work. China's leaders have decided to allow its citizens to make a profit. Once this decision is made, dictatorship is doomed. Rock music has entered China, computers have entered China, TV is in millions of homes in China, next will be the Internet. By allowing capitalism to move into China, the die is cast. The quest for money and the good life (already in high gear in China) will win out. The sons and daughters of today's leaders will give way increasingly to democracy. I say, "Infect China with capitalism." They will follow the money. Furthermore, the Chinese have always been excellent businessmen. I've said this before, but I'll repeat it, "When was the last time you saw a Chinese restaurant go broke?"

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I don't have one yet, but I'm close. I'm talking about digital cameras, which are becoming cheaper almost by the month. Furthermore, a growing number of photofinishers are offering scanning services. You check a box when you drop off or mail your exposed film, and your pictures will be developed and also digitized. For around five bucks extra, you will get your regular developed pictures plus image files which you can send to your brother in Seattle (isn't everyone moving to Seattle?) via e-mail. It's a new world out there, and the operative word is "digital."

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If you own an Internet stock and are paying the current price, well, you've got guts. Everybody wants to own a piece of the Net, but nobody knows what the hell's going on or what anything's worth. The big media companies all want a web provider or portal. Infoseek teamed up with Disney and Snap was snapped up by NBC. So far, Yahoo and Excite have nobody, and that may be a problem. Then there's American Online, which I gave up on because it was too darn slow and I felt not worth the money. I go directly into the Net via Time Warner's Road Runner. AOL could be locked out of high-speed connections if it isn't careful. AT&T wanted to buy AOL, but AOL turned them down. Personally, I would have taken the deal. AOL will have to partner with some phone network, maybe GTE or Sprint or even WorldCom. In the meantime, AOL is selling for over 100 bucks a share. And nobody, nobody knows how all this is going to work out. And hey, what if wireless comes in (as it did with the TV satellite) and gives cable a big run for its money?

This from *Business Week* (July 6), "AT&T must move fast to make its deal pay off. Wireless is waiting in the wings to boost the bandwidth so that it can transmit data as well as voice. A covey of new broadband satellite networks is ready to take flight soon. If wireless succeeds in mastering the technology and prices its services low enough, it could undercut all the hardwired providers of Net access, including AT&T." **Russell Comment:** And yet Microsoft, AT&T, Time Warner, they've all invested billions in cable. I know this -- I have both cable TV and satellite and I spend 80% of my time on the satellite.

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Y2K: Note that neither Bill Clinton or Al ("Techno-Geek") Gore has said much about Y2K, the great "millennium bug." Here's one scenario that the magazine, *Smart Money*, sees ahead, and they call it "a nightmare scenario" for Al Gore: "Hundreds of small and medium-sized banks around the country fail. Travel in America largely breaks down as many commercial airlines are forced to cancel their flights. A crisis occurs in health care as software that controls the dispensing of medication and treatment bogs down. Stock markets outside the US shut down, currency markets go wild and global financial systems teeter." From what I see, big business will be fairly ready for Y2K, part of government will be ready, but medium and small businesses will not be ready. The chief godfather of the Y2K doomsday scenario is economist Ed Yardeni, who originally put the odds for a Y2K-caused recession at 40%. Yardeni has now increased his odds to 70%, and he thinks that the downturn will be as bad as 1973-74. If you lived through '73-74 you will not be happy with Yardeni's predictions. Hey, do you know what the "techno-geek migration" is? It's the outward rush of the computer-wise crowd who are so worried about Y2K that they are quitting their jobs, stocking up with canned food and shot guns and moving to high ground in the less populated states. **Sane view:** Martin Weiss of *Safe Money Reports* states, "I already see signs that our know-how is being mobilized to correct the Y2K problem more quickly than you might have thought possible just months ago." Martin notes that "most critical centers of our financial system are well on their way to becoming Y2K complaint." He names the following as OK: the Clearing House Interbank Payment System, the SEC and NASD, the Fed's Fedwire system on interbank payments, and 97% of the brokerage houses and 84% of all firms will be ready for industry-wide testing by the end of this year. But what's this? Little known Data Integrity, Inc. of Waltham, MA has come out with a product, Millennium Solution, which cuts the time to make Y2K fixes by 80% on some software. It doesn't work on all systems but listen, it's a start. Where's Microsoft when we need it? Oh I forgot, they don't innovate. Apple maybe?

* *

Quote of the Week: "The US tax code is about 10 times the size of the Bible -- and unlike the Bible, it contains no good news." -- Assistant Senate Majority Leader Don Nickles. **Russell Comment**: Congress has done (as usual) the easy part. They've put through a bill to get rid of the current tax system. But they haven't presented anything else to take its place. GOP presidential hopeful Steven Forbes (by far the brightest of the candidates) says loud and clear that he wants a flat tax. George W. Bush, who probably will be the GOP candidate, hasn't stated where he is on taxes. Meanwhile, the hazy, lazy, contented American electorate doesn't seem to take an interest in anything except catastrophe movies and MTV -- even the current insane tax system doesn't move them to vote. They say as voters we get what we deserve, but I can't believe I deserve the present tax system (maybe I'm not voting often enough).

* *

It's clear that I'm going to have to go the e-mail route with Dow Theory Letters -- and I'm working on it now (I hope to post PTI levels plus comments almost daily.) Yet, I have to wonder what the devil the US Post Office is thinking of as they move to push up the first class rate another penny, to 33 cents a letter. As I see it (am I missing something), it's only a matter of time before most first class correspondence will go by either FAX or e-mail. Wait, I'll admit it, I prefer reading newspapers, comments, etc., on paper rather than on a screen. And I sure don't want to receive magazines on a screen. But electronic communication is instant and it's cheaper and it's the wave of the future. Who knows, in time most of the US Post Office buildings may end up as quaint museums, showing the public "how things used to be in the old days."

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Hong Kong, now in recession, has just completed one of the most expensive airports ever built, Chek Lap Kok. The main terminal is three-quarters of a mile long and ultra-modern, eight levels high and covering two million square feet of space and light. Unfortunately, the airport came to fruition at a bad time. The word was that when the Chinese took over, political life would be stifled but the economy would continue to boom. Things worked out just the opposite -- the Chinese takeover

produced very little in the way of political change but the economy tanked.

* *

Robert Rubin, US Treasury Secretary, used to be head of currency trading at Goldman Sachs. So you figure Rubin knows his currencies. Rubin is against currency devaluations. He claims a devaluation "generates additional inflation, discourages capital investment, encourages capital flight and greatly increases the problem of repaying debt." Of course, it was Rubin who encouraged the policy of higher rates so the US banks could buy bonds while loaning money out at lower rates, thus reliquefying the US banks and bringing them back to life after many of them were technically "under water." Many Asian countries (add S. Africa and Russia) have pushed their interest rates way up in an effort to make their currencies more attractive and to stave off a possible devaluation.

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An interesting interview appeared in a recent issue of the London *Financial Times*. The interview was with Nicholas Negroponte, author of the best-selling book, "Being Digital." This cyber-space guru predicted that the Internet would be a huge phenomenon before most people even knew of its existence. Negroponte also runs the Media Lab which is part of M.I.T. He is taken aback by the poor quality of the software in the market, Says Negroponte, "Each generation of software is worse than the last. It's a conspiracy. They pad the product with useless programs, then force you to buy it. I've been shocked with how easily the pubic swallowed Windows, which is a terrible, cumbersome system." He has invested in DigiCash because he believes credit cards will not be able to support all the transactions on the Internet. Electronic cash is a virtual debit card that allows the user to charge purchases on a pre-set cash account. "What is gives you is anonymity. I don't think people will want to hand over their credit card to everyone on the line." Negroponte is disappointed in Netscape's performance. "I expected Netscape to do better. They had such a head start. I think they stumbled because they forgot about the loyal customer like me, to concentrate on institutions. I don't use Netscape any more, do you?" As for Microsoft, "It's clearly a monopoly. But I agree with Bill Gates that there is a lot of innovation in the industry. It doesn't matter anyway, because Microsoft will break itself up soon. It's too big to control and Seattle is a dumb place to have it all located." The biggest boom in the Internet over the next decade will be a boom in popularity in developing countries. Five to eight years from now, the most commonly spoken language on the Net will be Chinese, not English. It is at that point that problems of low bandwidth will become obvious." Interestingly, the man who built his fame as the Internet's main cheerleader has begun to sound notes of caution about the system's speed and the importance of anonymity. **Russell Comment:** I like the *Financial Times* because it's a paper that gives you a seasoned, international view, rather than the basically US view projected by almost all US newspapers and magazines.

* *

I've never been a huge Sinatra fan, at least not as he sang in his gruff voice in his later years. But a marvelous new five-CD album has just been released. It's all of Sinatra's songs from his very early days with the great Tommy Dorsey band. Those were the days when Sinatra had his best voice. No faking, no working the mike, just pure voice. And lots of Dorsey's fabulous trombone (Sinatra stated that he learned to sing listening to Dorsey's breathing technique on trombone). This is the Sinatra that I grew up with during the '40s and '50s. There are over 80 classic songs, taken off the original studio master and digitally re-mastered. I bought the set (called, "The Song is You") from Amazon.com via the Net for a 10% discount; the set was delivered to me in three days.

* *

Remember when Bill Clinton promised to tell "more, rather than less, sooner, rather than later." Yeah right. It's now increasingly clear that Bill Clinton is not going to talk. The prez is going to take a chance on impeachment rather than answer all the questions that that nasty Mr. Starr would like to ask. Starr knows that the President perjured himself, but Starr won't drag Clinton into court -- so it looks as though all Starr's info and potential "impeachment material" will be handed over to the House. The House, if they believe the evidence is sufficient, will then turn the situation over to the Senate. The Senate has the power to impeach. Will Clinton be impeached, even on a perjury charge? I doubt it. The Republicans don't want to be responsible for ousting the President. One thing is certain -- Clinton has reduced the moral level of the US Presidency to its lowest level in recent history. Actually, on a deep level, I believe the American people have had their fill of Clinton-style corruption, regardless of what the polls say. All this hardly bodes well for Al Gore. Gore will always be tainted by his part in the Democratic Party's corrupt money-gathering methods. The polls already show that George W. Bush can beat Al Gore.

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The US is a very young country. I often read an item that makes me shake my head in wonderment. My father was born in 1892. Only 44 years before my dad was born, in 1848, the Mormon Battalion took a census of the San Diego population. Here's what they found: "A population of 248 Whites, three Sandwich Islanders, three Negroes, 483 'tame' Indians and 1,550 'wild' Indians." The "wild" Indians were a problem. Pleas from San Diegans to the federal Mexican government for military assistance from Indian uprisings were unanswered and there was talk of secession and formation of an independent state. Today, San Diego's main problem is not "wild Indians," it's that too many people have discovered that San Diego has the world's best climate and pleasantest living style. So like so many choice spots in the US, it's getting crowded here. **Everything in life's a trade-off**: California has Santa Ana winds, floods, droughts, coyotes that eat our pets and hungry mountain lions. Should I move to Florida? Nah, Florida has heat, humidity, bugs, fires and now, Asian Swamp Eels. The slimy eel is everywhere, it eats everything, and it's impervious to droughts, poison and cold. And it's spreading, spreading.

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Fret not, U.S. soccer fans, I have the solution to your woes. What the American Soccer Federation should do, you see, is assemble a soccer Dream Team (much like our unbeatable basketball Dream Team) to ensure that we simply roll through World Cup 2002 like no man's business. What's that? That *was* our soccer Dream Team? Never mind.

JIM MALLON
San Luis Obispo

US sports fans take their sports very seriously. As for soccer, we're just not there yet. And I don't think we will be until US soccer becomes a big-money sport in the style of football, basketball and baseball. I don't know if you saw the US/German game, but it wasn't exactly inspirational. Angry letters poured into the nation's newspapers. And in the great American tradition, the US coach was promptly fired. I thought this letter was a winner. Ah well ---

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Seriously, I often wonder, "Is Warren Buffett happier than I am? Is Bill Gates happier than I am? Do they feel more fulfilled?" It's darn sure they feel more fulfilled financially. And I ask myself, "Have I been too conservative? Have I been too diligent in avoiding stressful situations? Have I done all that I could have done in this life?" Nobody who has made BIG money has not wrestled with stress. I look at the pictures of the top executives as seen in *Fortune* or *Forbes*. Many of these guys look rather harried. Some look great, others look worn-out. My final conclusion: Life is a trade-off. I guarantee that Buffett and Gates have hidden problems that you and I wouldn't want. Nah, I wouldn't trade. I'll just stay Richard Russell (although if it's not too much to ask, I'd like to be about 30 years younger).

In the investing business, one of the big questions you should ask yourself (and not too many people do) is how much stress you're willing to accept. Taking a large position in the market is a thrill when the market is rising, but it's very stressful when the

market is declining. I don't care what you say, you don't know your level of stress until you get caught with a large portfolio in a market's that heading down. So it's very good to think about how much stress you can take before assuming your stock or bond positions. I remember this vividly, it was in late-1943 in Italy. On one particular combat mission with flak exploding everywhere, I said to myself, "If I ever get out of this war alive I swear I'll never worry or stress again." Wrong, I still worry and stress. The stresses since then have just been at a lower level. But admission -- I hate stress, and I'm convinced that stress is a silent killer.

* *

Guys and gals, you're getting old (and you know who you are) if you remember when the NYSE ticker symbol, A, stood for mighty Anaconda, when B was for Baldwin Lima (leading US builder of locomotives), and when L stood for the great Sinclair Oil Corp. Do you remember (all on the NYSE) Avco, Welbilt, Kennecot, Bucyrus-Erie? Do you remember Berkshire Hathaway at 250 (I bought it at 250 and sold it grrrr, for 500)? You're getting up there in years if you remember daily volume of 2.5 million a day, if you used to buy stocks through Redpath Parker or DuPont or Loeb Rhodes or even Hutton. Hey old timers, do you remember Kennedy scolding the steel companies just before the market collapsed in '62? You've got gray hair if you remember the Dow at 520 in 1956 or the Dow at 212 in '46. And who can ever forget the Dow at 577 in late-1974 as Wall Street whined that the stock market, as we knew it, was finished, a has-been, and that we were all witnesses to the end of capitalism?

More on Satellites: Half the world has never made a phone call, and the global average is 12 phones for every 100 people (the US has 60 phones per 100). The satellites will change all that within the next five to 10 years. Satellite networks can be built and launched for a fraction of the cost of laying phone cables. So major companies are launching more than half a dozen multi-billion dollar satellites. Motorola last week announced a major satellite venture, a $13 billion 63 satellite system that will bring global customers Internet and video transmission starting in 2001. That will present a direct challenge to Microsoft and McGaw with their similar system called Teledesic. At the same time, Matra Marconi Space (a European company) announced a $2 billion satellite system. And there's TRW with its Odyssey network, a $3 billion venture that will put 12 satellites in orbit in 2001-'2, capable of relaying phone calls from 6,000 miles up.

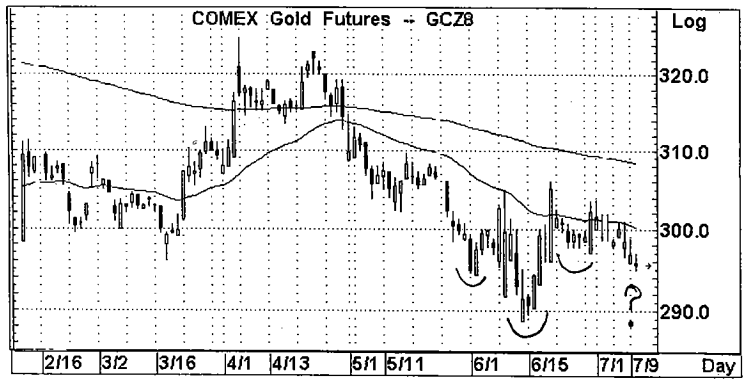
GOLD: The story is in the chart pattern, if only we had the brains to read the pattern correctly. Well, I'll try. When I wrote the last Letter the December gold futures appeared to be etching out a bottom. In fact, it looked as if gold had traced out a bullish "head-and-shoulders" bottom, as seen on the chart. I said in the last Letter that the breakout from this pattern would require the December futures to move out above 306. That hasn't happened yet.

Is gold toying with me? Are the gods of the yellow metal mocking my ability to analyze charts? Yeah, they've been doing that for decades. But seriously, it would have been much better if, instead of extending its potential "right shoulder" sideways, gold had moved up above its 34-day moving average and then above 306.

On a longer term basis, gold is in a negative position since its actual price is below its 34-day MA, and the 34-day MA, in turn, is below the 144-day MA. It's sad to say this, but the best that can be said for gold is that it has not yet fallen below its June 15 low. The 34-day MA for gold stands at 300 even. The first hopeful hint for gold bulls would be the metal rising firmly above 300.

LATE THOUGHTS, NOTES: Readers should keep in mind that the "Late Notes" represent my **latest** (and **often most important**) thoughts on the market. These Notes are usually written on the weekend or on Monday just prior to publication.

If ever a market appeared to ignore the fundamentals, the



historic valuation measures and the problems of the rest of the world, it's this market. For this reason I'm relying more and more on the technical indicators, including Dow Theory, my PTI, the A-D ratio and most recently the Big Breadth Index.

Consider this: Over the last two years the Indonesian economy has declined by almost 80%, Thailand's by 50%, S. Korea's by 45%, Malaysia's by 25% -- with former stalwarts Singapore and Hong Kong now in deepening recessions. Japan, the world's second largest economy, is dealing with a stock market that has lost two-thirds of its value. The fact is that the losses in many Asian economies and stock markets are comparable to the horrendous collapse of the US stock market and economy during 1929-'32. Meanwhile, a front page article in the July 10 *WSJ* details how US workers are living it up, buying houses, cars and enjoying vacations to foreign lands. Global schizophrenia.

The question: Can the US continue to send its stock market into the clouds while a third of the world is literally in depression? And the answer -- the answer is, so far, yes. But the best answer is the one supplied by the stock market. As long as this finest of all barometers continues to rise or at least hold, it's reasonable to assume that US prosperity can go marching along.

Next question: Is there anything in the current market picture worth worrying about? I've been watching and studying markets since the mid-1940s, and I consider myself an "expert on seeing or sensing whether anything is wrong." Here are a few of the items that I'm watching carefully, a few items that could lead to trouble. **(1)** It bothers me that week after week goes by without a new Dow high. Remember, the S&P has advanced to record highs but the Dow has stubbornly refused to confirm. The Dow isn't just any average, it's an average composed of 30 of America's greatest and largest blue-chip corporations. It's the most watched and analyzed average in the world. Why isn't the Dow rising to new highs, thereby confirming the S&P? Why, why? It's a worry.

(2) Of course, the Transports have also failed to register a new high. This bothers me. The Transports provide a good measure of "how many and how much" of America's goods are moving. The Transports hit their high on April 16, two months ago. Why aren't they higher today? **(3)** Market breadth has been outstandingly poor since mid-April. It's as if we have two totally separate markets, a selected pack of blue-chips and then there's the rest of the market. Will the blue-chips drag the rest of the market up -- or will the majority of stocks pull the blue-chips down? Can't tell yet, but these schizophrenic splits in the market MUST be resolved. **(4)** The wild speculation in the Internet stocks reminds me too much of 1968 and other periods where frenzied buying in a certain group covered up weakness in the general market. I like calmer markets led by many groups and confirmed with a powerful rising A-D ratio. This ain't it.

Conclusion: The **strength** of this market is reflected in the upside action of the Big Breadth Index (BBI); the **weakness** is expressed in the sick performance of the A-D ratio. Therefore, it is crucial that the BBI continue to rise. If the BBI turns down, that will be a clear signal for trouble. Meanwhile, the MZM money supply continues to surge (meaning a flood of liquidity).

NEXT MAILING: July 29, 1998